HOMEWORK #3 (PART 2 OF 2)
Due Nov 11 IN CLASS
NO LATE SUBMISSION IS ACCEPTED
Please TYPE and STAPLE your work
Graphs and formulas can be drawn by hand
The number of points here sums up to 15

QUESTION 3.5 (3 pts)
Suppose you work for the government as an economic advisor. Your boss tells you that
the government is considering taxing luxury boats because taxing rich people seems to be
a good political move. By studying survey data, you know that the price elasticity of
supply for luxury boats is 0.23. You also determine that the price elasticity of demand for
luxury boats is 1.85. Using this information, sketch the initial market for luxury boat.
Add a tax to your diagram. Who bears the burden of this tax? Would taxing luxury boats
achieve the desired result (taxing reach people heavily)? Construct a table which fully
indicates all surpluses before and after the tax.

QUESTION 3.6 (3 pts)
Consider the market for higher education in the United States. Graphically illustrate
initial equilibrium in the higher education market. Suppose the government decides that
higher education is an important good and everyone should have access to higher
education. To facilitate this, the government subsidizes higher education. Graphically
illustrate the market for higher education after the subsidy. Construct a table fully
indicating all surpluses before and after the subsidy.

QUESTION 3.7 (1 pts)
Derive the Laffer Curve (a relationship between tax size and Government revenues).
Your answer should consist of 4 graphs, one of which is the Laffer Curve.

QUESTION 3.8 (8 pts)
Consider a monopolist who can sell the good in two different countries (so that two
markets are completely separate: customers cannot move from one market to the other).
Suppose that the demand in the country One is $P = 10 - Q_1$, that demand in the country
Two is $P = 15 - 2Q_2$. Marginal revenue of the monopolist, therefore, is different for two
markets. Assume that in country One, $MR(Q_2) = 10 - 2Q_1$ and in country Two $MR(Q_1) =
15 - 4Q_2$. Marginal Cost of the monopolist is given by $MC(Q_1 + Q_2) = Q_1 + Q_2 + 3$.
Suppose that the monopolist is selling the amounts of Q_1 and Q_2 such that $MR(Q_1) =
MR(Q_2) = 8$. Are these Q_1 and Q_2 profit maximizing quantities? If yes, explain why and
find Q_1 , Q_2 and the corresponding prices on the two markets. If no, explain why are these
quantities not profit maximizing.